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- Mr Lars Overby – *Head of Risk-based Metrics, EBA*

RTI/Let. 065

Brussels, 25 April 2023

Subject: European Commission's proposed amendment to the draft EBA RTS on IRRBB SOT

Dear Mr Berrigan,
Dear Mr Campa,

The European Savings and Retail Banking Group (ESBG) would like to follow up regarding the European Banking Authority (EBA) draft regulatory technical standards (RTS) in the field of interest rate risk in the banking book (IRRBB), with a specific focus on the calibration of the supervisory outlier test (SOT) for the net interest income metric (NII).

ESBG and its members expressed serious concerns regarding the EBA's planned NII SOT in our letter dating 20 December 2022. The threshold of 2,5% in NII suggested by the EBA is not appropriate as it was calibrated during a period of very low interest rates and does not reflect the recent evolution of monetary policy and the current interest rate environment. Its application would result in a disproportionate number of banks that could appear as outliers, with a potential additional capital requirement impact on those institutions, and with non-risk sensitive changes that institutions would have to implement to avoid being wrongly perceived as outliers.

In order to respond to the industry concerns, as far as we know, the European Commission suggested amending Article 6 of the RTS by introducing a new definition of "large decline" (which triggers the identification of a bank as outlier) based on two elements:

1) A ranking of banks elaborated by competent authorities, and
2) A decline of net interest income higher than 2.5% of a bank's Tier 1 capital.

While we welcome the Commission's attempt to broaden the outlier test and to ensure that the outcomes are more realistic, we also believe that the amendment does not remediate the industry concerns about the 2,5% threshold and it would instead add increased complexity and a lack of clarity. More specifically we believe that:

- The proposal **lacks transparency** regarding the ranking process and an uncertainty about whether a NII decline exceeding the threshold results in being an outlier institute. The criteria for identifying outliers would be dependent on other banks' NII SOTs, which are non-public information, leaving the opportunity for competent authorities to rank different types of institutions at their discretion and without clarity on how the business models and risk profile of institutions are taken into account. The ranking approach is also **not risk sensitive** given that, as long as all banks don't have the same level of NII SOT, there will always be banks classified as outliers without necessarily having a realistically high IRRBB exposure.

- The proposal brings **more complexity** to the position steering and risk management process and does not mitigate the need for significant additional derivative hedging positions in small banks having no experience on the derivative markets and countries/currencies where respective derivative markets are not liquid at all.

- The suggested approach would **increase uncertainty** for banks in how to comply with the RTS and add additional discretionary power to supervisors. Given that the ranking method is based on past NII SOTs, the ranking method would result in the thresholds continuously changing overtime, thus leading to an unlevel playing field where banks could be classified into multiple categories at the discretion of competent authorities.

- Ultimately, the **2.5% SOT NII threshold would remain the only reference for banks and stakeholders.** Institutions would still manage their operations based on the 2.5% Tier 1 threshold as this would be the only clear indicator available and would still serve as a benchmark for market participants and other external stakeholders.

For the reasons outlined above, we believe that the proposed approach is flawed and would recommend postponing the calibration of the SOT NII threshold to allow for a thorough analysis of the sensitivity and structural aspects of banks' interest rate risk management as well as the changes brought on by recent monetary policy developments. It should be considered that the ranking method would imply the exact same corrective action as keeping the original 2,5% threshold with consequence in terms of systemic risk and negative impact on banks profitability. Consequently, any monitoring efforts aimed at recalibrating the threshold to a more realistic level would be unsuccessful as banks would have already converged towards the 2,5% level.

Against this background, as a temporary solution, **ESBG would recommend that the EBA instead sets a higher threshold to a more consistent level of 7,5%[1] in combination with a transition period (of at least 18 months)** and issues a clear statement outlining the consequences that a bank would incur into from being an outlier institute in order to secure a level playing field.

Thank you very much in advance for taking our proposal into consideration and we remain at your disposal should you have any further questions.

Sincerely yours,

Peter Simon

[1] 1 The 7,5% level is set based on the level emerging from the Parallel Down Unconstrained scenario of the 2021 QIS1, i.e. between the -7.2% and -7.6% according to the QIS outcomes as reported in the accompanying documents of the Final Report Draft RTS.